

# Senate Study Bill 1062

SENATE FILE \_\_\_\_\_  
BY (PROPOSED COMMITTEE ON WAYS  
AND MEANS BILL BY  
CHAIRPERSON McKIBBEN)

Passed Senate, Date \_\_\_\_\_ Passed House, Date \_\_\_\_\_  
Vote: Ayes \_\_\_\_\_ Nays \_\_\_\_\_ Vote: Ayes \_\_\_\_\_ Nays \_\_\_\_\_  
Approved \_\_\_\_\_

## A BILL FOR

1 An Act establishing a new economy employment initiative by  
2 providing for a partial deduction under the individual income  
3 tax for the capital gain from the sale or exchange of capital  
4 stock of a corporation acquired by an individual on account of  
5 employment with the corporation, limiting the fiscal impact of  
6 the partial deductions, and including an effective and  
7 retroactive applicability date provision.  
8 BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:  
9 TLSB 1599XC 80  
10 mg/cl/14

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1 1 Section 1. Section 422.7, Code 2003, is amended by adding  
1 2 the following new subsection:  
1 3 NEW SUBSECTION. 39. a. For purposes of this subsection:  
1 4 (1) "Capital stock" means voting and nonvoting common and  
1 5 preferred stock and stock options issued pursuant to an  
1 6 incentive stock option plan. "Capital stock" does not include  
1 7 stock rights, stock warrants, or debt securities, and does not  
1 8 include stock or stock options issued by a corporation which  
1 9 does not offer incentive stock options to all full-time  
1 10 employees. A corporation does not offer incentive stock  
1 11 options to all full-time employees unless each of those  
1 12 employees is issued at least a number of incentive stock  
1 13 options equal to twenty percent of all issued outstanding  
1 14 incentive stock options divided by the number of full-time  
1 15 employees.  
1 16 (2) "Corporation" means any of the following:  
1 17 (a) A corporation which at the time of the first sale or  
1 18 exchange for which an election is made under paragraph "c" has  
1 19 been in existence and actively doing business for at least  
1 20 three years and is not a personal holding company as defined  
1 21 in section 542(a) of the Internal Revenue Code.  
1 22 (b) A corporation which is a member of an affiliated  
1 23 group, as defined in section 1504(a) of the Internal Revenue  
1 24 Code, which group includes a corporation described in  
1 25 subparagraph subdivision (a) and which group has been in  
1 26 existence and actively doing business for at least three  
1 27 years.  
1 28 (c) A predecessor or successor corporation of a  
1 29 corporation described in subparagraph subdivision (a). A  
1 30 corporation is a predecessor or successor corporation if the  
1 31 corporation was a party to a reorganization that was entirely  
1 32 or substantially income tax free and that occurred during or  
1 33 after the employment of the taxpayer making an election under  
1 34 paragraph "c".  
1 35 (3) "Incentive stock option" means the same as defined in  
2 1 section 422(b) of the Internal Revenue Code.  
2 2 b. For purposes of this subsection, the corporation  
2 3 issuing capital stock for which an election under paragraph  
2 4 "c" is made must, at the time of the first sale or exchange  
2 5 for which the election is made, have at least five  
2 6 shareholders and at least two shareholders or groups of  
2 7 shareholders who are not related to each other and each of  
2 8 whom owns at least five percent of the capital stock.  
2 9 For purposes of this paragraph "b", two persons shall be  
2 10 considered to be related when, under section 318 of the  
2 11 Internal Revenue Code, one is a person who owns, directly or  
2 12 indirectly, capital stock that if directly owned would be  
2 13 attributed to the other person or is the spouse, child,  
2 14 parent, grandparent, brother, sister, aunt, uncle, cousin,  
2 15 niece, or nephew of the other person who owns capital stock  
2 16 either directly or indirectly.  
2 17 c. (1) In the manner provided in paragraph "d", an

individual may elect to subtract one-half of the capital gain from the sale or exchange of capital stock of a corporation acquired by the individual on account of employment with that corporation. However, for tax years beginning in the 2003 calendar year, the amount that may be subtracted is one-fourth of such capital gain.

(2) (a) Each individual shall be entitled to two elections under subparagraph (1) during the individual's lifetime for the capital stock of two different corporations.

(b) The election applies only to the tax year for which the election was made and applies to all sales and exchanges in the tax year for which the election was made of capital stock in the same corporation which was acquired as provided in subparagraph (1).

(c) After the individual makes an election for the tax year, the election shall also apply to the sale or exchange in that tax year of capital stock of the corporation which had been transferred by inter vivos gift from the individual to the individual's spouse if the capital stock was acquired as provided in subparagraph (1). This provision applies in the case of the spouse, only if the spouse was married to such individual on the date of sale or exchange or the date of death of the individual and if the spouse and individual file a joint Iowa income tax return on which the election is made. If the individual dies without making an election, the surviving spouse may make the election for capital stock that would have qualified under this subparagraph subdivision.

However, if there is no surviving spouse, the oldest surviving issue who owns capital stock that would have qualified under this subparagraph subdivision may make the election.

d. An election under paragraph "c" shall be made by including a written statement with the taxpayer's Iowa income tax return for the tax year for which the election is made. The written statement shall identify the corporation that issued the capital stock, the grounds for the election under this subsection, and that the taxpayer elects to have this subsection apply to sales and exchanges in that tax year.

(1) In order for the taxpayer to claim the benefits of the partial deduction of the capital gain under this subsection, the taxpayer must completely fill out the tax return, determine the taxpayer's income tax liability without the benefit of this subsection, and pay the amount of tax owed. The taxpayer shall recompute the taxpayer's income tax liability, by applying the provisions of this subsection on a special return. This special return shall be filed under rules of the director and constitutes a claim for refund of the difference between the amount of tax the taxpayer paid as determined without the application of the provisions of this subsection and the amount of tax determined with the application of the provisions of this subsection.

(2) This subsection shall not affect the amount of the taxpayer's checkoff to the Iowa election campaign fund under section 56.18, the checkoff for the state fish and game protection fund in section 456A.16, the credits from tax provided in sections 422.10, 422.11A, and 422.12 and the allocation of these credits between spouses if the taxpayers filed separate returns or separately on combined returns.

(3) For any calendar year, the aggregate amount of refund claims that shall be paid pursuant to this subsection for all tax years beginning in that calendar year shall not exceed three million dollars. If, for a calendar year, the aggregate amount of refund claims filed pursuant to this subsection for all tax years beginning in that calendar year exceeds three million dollars, each claim for refund shall be paid on a pro rata basis so that the aggregate amount of refund claims paid does not exceed three million dollars. In the case where refund claims are not paid in full, the amount of the refund to which the taxpayer is entitled under this subsection is the pro rata amount that was paid and the taxpayer is not entitled to a refund of the unpaid portion and is not entitled to carry that amount forward or backward to another tax year.

Taxpayers shall not use refunds as estimated payments for the succeeding tax year. Taxpayers whose tax years begin on January 1 must file their refund claims by October 31 of the calendar year following the end of their tax years to be eligible for refunds. Taxpayers whose tax years begin on a date other than January 1 must file their refund claims by the end of the tenth month following the end of their tax years to be eligible. The department shall determine on February 1 of the second succeeding calendar year if the total amount of claims for refund exceeds three million dollars for the

4 29 calendar year. Notwithstanding any other provision, interest  
4 30 shall not be due on any refund claims that are paid by the  
4 31 last day of February of the second succeeding calendar year.  
4 32 If the claim is not payable on February 1 of the second  
4 33 succeeding calendar year, because the taxpayer is a fiscal  
4 34 year filer, the claim shall be considered as a claim for the  
4 35 following calendar year.

5 1 e. The deduction under this subsection is in lieu of any  
5 2 deduction allowable under section 1202 of the Internal Revenue  
5 3 Code for the capital gain from the sale or exchange of the  
5 4 same capital stock.

5 5 Sec. 2. EFFECTIVE AND RETROACTIVE APPLICABILITY DATE.  
5 6 This Act, being deemed of immediate importance, takes effect  
5 7 upon enactment and applies retroactively to January 1, 2003,  
5 8 for tax years beginning on or after that date.

5 9 EXPLANATION

5 10 This bill provides a deduction under the individual income  
5 11 tax of 50 percent (25 percent for the 2003 tax year) of the  
5 12 capital gain from the sale or exchange of capital stock of a  
5 13 corporation acquired by the taxpayer on account of employment  
5 14 with the corporation. The taxpayer must make an election to  
5 15 take the deduction and the election only applies for that tax  
5 16 year. The election is made by a written statement filed with  
5 17 the department. In addition, the benefits of the deduction  
5 18 are realized by means of a refund claim. This involves the  
5 19 taxpayer filing a return with tax liability determined without  
5 20 deduction for the capital gain and a special return with tax  
5 21 liability determined with the deduction for the capital gain.  
5 22 The reduction in tax liability will be treated as a claim for  
5 23 refund of the amount of the reduction. However, not more than  
5 24 \$3 million in tax refunds may be allowed for all tax years  
5 25 beginning in the same calendar year. If more refunds are  
5 26 claimed, then each refund claim is payable at a pro rata  
5 27 amount, which is the final amount of the taxpayer's actual  
5 28 refund. A taxpayer may make two elections for two different  
5 29 corporations during the taxpayer's lifetime. The election  
5 30 would also apply to stock sold during that tax year which was  
5 31 previously granted to a spouse of the taxpayer but only if  
5 32 they file a joint Iowa income tax return. The election would  
5 33 not apply to capital gains from stock or stock options unless  
5 34 the corporation issuing the options offered them to all full-  
5 35 time employees.

6 1 The deduction is in lieu of the deduction that may be  
6 2 allowable under the Internal Revenue Code for sale or exchange  
6 3 of stock in a small business held for five years.

6 4 The bill takes effect upon enactment and applies  
6 5 retroactively to January 1, 2003, for tax years beginning on  
6 6 or after that date.

6 7 LSB 1599XC 80

6 8 mg/cl/14